

**Office of Chief Counsel
Internal Revenue Service**

memorandum

CC:LM:NR:DEN:POSTF-124354-02

WRDavis

date: **July 22, 2002**

to: Team Manager, LMSB:HMT: [REDACTED]

from: Area Counsel
(Natural Resources:Houston)

subject: **Request for Counsel Assistance: May a Taxpayer Modify the Amount of Costs Capitalized Under I.R.C. § 59(e) Without Consent if it Previously Elected Such Treatment for a Different Amount?**
Taxpayer: [REDACTED] **Corporation and Subsidiaries**
TIN: [REDACTED] **Tax years** [REDACTED]
Address: [REDACTED]

We provide this revised memorandum to clarify whether the taxpayer may modify the amount that it previously elected to capitalize under I.R.C. § 59(e). It contains revisions made in accordance with recommendations provided by Chief Counsel National Office, and replaces the advice contained in our memorandum dated July 12, 2002. This memorandum should not be cited as precedent.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

ISSUES

May the taxpayer modify the amount of costs that it has elected to capitalize and amortize under I.R.C. § 59(e) after it previously made the election?

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CONCLUSIONS

Absent consent to revoke the original election, a taxpayer may not modify the amount that it has previously elected to capitalize and amortize under section 59(e).

FACTS

██████████ Corporation (██████████) filed a consolidated corporate income tax return for itself and its affiliated subsidiaries as the common parent, for its taxable years ██████████ through ██████████ (tax years under audit), in accordance with I.R.C. § 1501 et seq. and the regulations thereunder. During that year, ██████████ Company (██████████) was a wholly-owned subsidiary of ██████████ and a member of the ██████████ consolidated group.

The ██████████ consolidated return for ██████████ included ██████████'s election under section 59(e) to capitalize mine development expenditures totaling \$██████████. The election reflected that the expenditures related to the ██████████ and ██████████ mining properties, in the amounts of \$██████████ and \$██████████, respectively. According to the taxpayer, the section 59(e) election covered ██████████% of the costs incurred with respect to the ██████████ mine and ██████████% of the costs for the ██████████ mine.

During the course of the audit, the audit team discovered that, beginning in ██████████ and continuing through ██████████, the taxpayer had claimed increased section 59(e) amortization costs attributable to ██████████ expenditures. The additional ██████████ expenses on which the amortization was claimed were \$██████████ in mine development costs, and \$██████████ in section 174 costs. Pursuant to the audit team's questions regarding the claimed amortization expenses, the taxpayer proposed modifying the amount capitalized and amortized under section 59(e) in ██████████ that was attributable to mine development expenditures by increasing the amount by \$██████████. The increase is attributable to ██████████% of the mine development expenditures incurred at ██████████ mines other than ██████████ and ██████████. In addition to setting forth the amounts and properties to which the increased amount related, it identified the amounts and properties to which the originally elected amount related differently than in the election contained in the return.¹

¹ The taxpayer's response stated that the original \$██████████ was comprised of \$██████████, \$██████████, and \$██████████ relating to costs incurred at the ██████████, ██████████, and ██████████.
(continued...)

In addition to the proposal to increase the [REDACTED] mine development expenditures subject to the section 59(e) election, the taxpayer submitted a memorandum to the audit team stating that the taxpayer had decided to make a retroactive section 59(e) election for \$[REDACTED] in research and experimentation costs incurred in [REDACTED], which had previously been deducted pursuant to section 174.

No documents, other than the audit responses described above, were submitted by the taxpayer in seeking the change to the amounts subject to the section 59(e) election for [REDACTED].

ANALYSIS

Section 59(e)(1) allows a taxpayer to elect to capitalize and amortize any "qualified expenditure" for regular tax purposes. These capitalized costs are not treated as tax preference items under section 57(a), and section 56 does not apply to them. Section 59(e)(6). Qualified expenditures include, among other things, research and experimental expenditures and mine development and exploration expenditures. Section 59(e)(2).

Section 59(e)(4)(A) provides that a section 59(e)(1) election can be made with respect to any portion of any qualified expenditure. The legislative history of section 59(e) indicates that an election under this section may be made "dollar for dollar." Thus, for example, a taxpayer who incurs \$100,000 of intangible drilling costs with respect to a single well may elect to capitalize and amortize any portion of that amount. S. Rep. No. 313, 99th Cong., 2d Sess. 539 (1986), reprinted in 1986-3 (Vol. 3) C.B. 1, 539; H.R. Rep. No. 426, 99th Cong., 1st Sess. 327 (1986), reprinted in 1986-3 (Vol. 2) C.B. 1, 327. Section 59(e)(4)(B) provides that an election under section 59(e)(1) can only be revoked with the consent of the Secretary. Section 59 does not specify the time or manner for making a section 59(e) election.

Section 59(e)(4) permits a taxpayer to make an election with respect to any portion of any qualified expenditure. Taxpayer made a valid section 59(e) election to capitalize and amortize a

¹(...continued)
properties, respectively. The response indicates that the total amount of [REDACTED] mine development expenditures at the [REDACTED] property only amounted to \$[REDACTED], far less than the \$[REDACTED] identified in the election.

specific amount of costs on its original tax return for [REDACTED]. Any change in the amounts of costs capitalized and amortized under section 59(e) would first require a revocation of the original election. Since the taxpayer has not obtained the Secretary's consent, such a change is not permitted.

Under the "doctrine of election," taxpayers are bound by their original elections and are precluded from revoking the elections made on their original returns.² In order for the doctrine of election to apply to Federal tax law, the following two elements must exist: (1) there must be a free choice between two or more alternatives, and (2) there must be an overt act by the taxpayer communicating the choice to the Commissioner, i.e., a manifestation of choice. Grynberg v. Commissioner, 83 T.C. 255, 261 (1984); Bayley v. Commissioner, 35 T.C. 288, 298 (1960); see Pacific Nat'l Co. v. Welch, 304 U.S. 191 (1938). Such was clearly the case here.

The Pacific Nat'l rule has been succinctly paraphrased: "Once the taxpayer makes an elective choice, he is stuck with it." Roy H. Park Broadcasting, Inc. v. Commissioner, 78 T.C. 1093, 1134 (1982); United States v. Helmsley, 941 F.2d 71, 86 (2d Cir. 1991). This especially applies where an election is affirmatively made in a timely-filed return, and the benefits of the election are reflected on the return as prepared and filed by the taxpayer. Grynberg, 83 T.C. at 261; see Goldstone v. Commissioner, 65 T.C. 113 (1975); Estate of Stamos v. Commissioner, 55 T.C. 468, 473 (1970).

Furthermore, the Tenth Circuit, the circuit to which this case would be appealable, has adopted and applied the doctrine of election in Federal tax controversies. See Estate of Darby v. Wiseman, 323 F.2d 792 (10th Cir. 1963); Ackerman v. United States, 318 F.2d 402 (10th Cir. 1963).

² We note that Chief Counsel Notice 2002-027 reflects a change in the Service's litigating position with respect to the doctrine of election. However, our reading of that notice finds that it only applies to situations where application of that doctrine would preclude a taxpayer from amending past years' returns to elect retroactively to value assets according to their fair market values for purposes of apportioning interest expense under Temp. Treas. Reg. § 1.861-9T(g).

Taxpayer's Position, Hazards, and Other Considerations

In a memorandum, the taxpayer's attorney posits that "[t]he plain meaning of Section 59(e)'s language, and the clear import of its legislative history, is that Section 59(e) provides separate elections with respect to each qualified expenditure." It supports this proposition by reference to the "dollar-for-dollar" language of the Congressional committee reports, and analogizes it to a "well-by-well" election. It concludes that since the taxpayer only made an election with respect to the [REDACTED] and [REDACTED] mines with the tax return, it may still make an election to apply section 59(e) for costs incurred in any other mine not identified in the election included with the return.

We view the meaning of the legislative history differently. First, the balance of the explanation of section 59(e) fails to mention this presumed right to make a property-by-property election. With taxpayers holding potentially hundreds of properties where such expenses could occur, approval of the taxpayer's view would leave the final determination of the taxpayer's tax open until the period of limitations for refund or credit for that tax year expired, and could permit hundreds of elections subsequent to the taxpayer's initial election. The legislative history, in no way, reflects any contemplation of such a scheme.

Further, if the taxpayer's argument is correct, there is no reason why the taxpayer's decision not to elect section 59(e) treatment for a portion of the costs related to a particular mine would preclude it from later electing that treatment for that portion of those costs. The legislative history is as silent on such treatment for the "unelected" costs of a property for which the taxpayer has elected to subject some portion of those costs to section 59(e) as it is for properties not included in the initial election. For example, under the taxpayer's reading, nothing would prevent it from making multiple subsequent elections for any portion of the [REDACTED] of mine development costs from the [REDACTED] mine excluded from its initial election.

However, to accept such a reading would essentially eliminate the requirement of section 59(e)(4)(B) that an election can only be revoked with the consent of the Secretary. Under the taxpayer's interpretation, the Secretary's consent is needed only if the taxpayer seeks to reduce the amount of costs subject to section 59(e) treatment, since the addition of any costs that were not previously included in a section 59(e) election would

constitute the initial election for those costs.³ The statute does not say this. Nor can it reasonably be interpreted as allowing this.

Finally, we note the taxpayer's highlighting of the Service's failure to issue regulations or other authoritative guidance interpreting section 59(e) since its enactment. Citing to First Chicago Corporation v. Commissioner, 842 F.2d 180 (7th Cir. 1988), it points out that where the Service has failed to issue clarifying guidance in other areas, it cannot complain about the court's interpretation of those statutes in a manner contrary to the Service's view. That case concerned I.R.C. § 58(h) (1976), a part of the prior minimum tax scheme. That provision directed the Secretary to prescribe regulations under which tax preference items, the tax treatment of which did not reduce the taxpayer's tax for any taxable year, were to be adjusted.

In contrast, section 59(e) contains no specific direction for the Service to issue regulations (although the legislative history does). Our analysis indicates why we believe the taxpayer, while enjoying the flexibility of determining what portion of its expenditures for each property it chooses to subject to section 59(e) treatment, is entitled to make a single election per return, not a dollar-for-dollar or a property-by-property election. (b)(5)(AC)

[REDACTED]

³ In its memorandum, the taxpayer disagrees with the Service's conclusion in P.L.R. 9848003 (July 29, 1998), which rejected a taxpayer's attempt to modify the amount capitalized and amortized under section 59(e) as a revocation of the election, for which consent had not been obtained. Therein, the taxpayer notes that the legislative history of section 59(e) provides no guidance concerning the scope of section 59(e)(4)(B), which requires the Secretary's consent to revoke an election. Yet, it indicates that if the circumstances behind P.L.R. 9848003 concerned a taxpayer's wish to adjust the amount of a particular expenditure that was amortized under section 59(e), then the analysis and conclusion would be supported by the language and legislative history behind section 59(e).

Questions regarding this memorandum should be directed to the undersigned at (303) 844-2214, ext. (b)(6).

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By: _____
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Attachment:
Taxpayer's memorandum